



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

Draft

Date Introduced: **02/22/02**

Bill No: **SB 1901**

Tax: **Sales and Use**

Author: **Machado**

Board Position:

Related Bills:

**BILL SUMMARY**

This bill would authorize a qualified person, as defined, to issue an exemption certificate to a diesel fuel supplier with respect to that portion of diesel fuel that the qualified person reasonably expects to sell to farmers and food processors that qualify for the state sales and use tax exemption, under specified conditions.

**ANALYSIS**

**Current Law**

Existing law imposes a sales or use tax on the gross receipts from the sale of, or the storage, use, or other consumption of, tangible personal property, unless specifically exempted by statute. Under existing law, sales of diesel fuel are generally subject to sales or use tax. However, Section 6357.1 was added to the Sales and Use Tax Law by AB 426 (Ch. 156 of the 2001 Legislative Session) to provide a state General Fund sales and use tax exemption that became operative on September 1, 2001, for the sale and purchase of diesel fuel used in farming activities and food processing.

Under existing law, distributors and brokers of diesel fuel are required to collect a prepayment of sales tax from the person to whom the diesel fuel is transferred. When the person acquiring the diesel fuel resells that fuel, the person is entitled to claim credit for the prepayment paid to the supplier on the return for the period in which the fuel is resold. The tax prepayment rate for diesel fuel is determined by the Board based upon 80% of the combined state and local tax rate multiplied by the arithmetic average selling price (excluding tax) as determined by the Board – currently at a rate of 8 cents per gallon. The law provides that if the price of diesel fuel decreases or increases, and the established rate results in prepayments that consistently exceed or are significantly lower than the retailers' sales tax liability, the Board may readjust the rate.

**Proposed Law**

This bill would add Section 6480.3 to the Sales and Use Tax Law to provide that a qualified person may issue a certificate to a seller to exempt his or her purchase of diesel fuel from the prepayment requirements when purchasing diesel fuel that qualifies for the exemption from the state sales and use tax under Section 6357.1. Among other things, the bill would specify that the certificate indicate the volume of diesel fuel that the person reasonably expects he or she will sell that qualifies for the exemption under Section 6357.1.

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The bill would specify that a person is qualified if both of the following conditions are met:

1. The person sold diesel fuel that was used by the consumer in a manner that qualified, or would have qualified for an exemption under Section 6357.1, and in the prior year, those sales totaled more than 25 percent of that person's total taxable sales, and
2. The person's sales consist primarily of either bulk deliveries of 500 gallons or more or of fuel sales through a cardlock, keylock, or other unattended mechanism, or both.

The bill would also specify the following:

1. A person issuing the certificate is liable for the local and transactions and use taxes, and any sales tax on any portion of the gross receipts from the sale of the fuel that is not sold in a manner that qualifies for an exemption under Section 6357.1.
2. A person liable for the sales tax shall report and pay that tax with the return for the reporting period in which the person sells the fuel.
3. Any person who gives a certificate pursuant to this section for purchases of diesel fuel that he or she knows at the time of purchase do not qualify for the exemption from the prepayment for the purpose of evading the prepayment of the tax is guilty of a misdemeanor and, in addition, shall be liable to the state for penalty of \$1,000 for each certificate so issued.

The bill would become operative January 1, 2003.

### Background

Several retailers of diesel fuel who have a large volume of sales to farmers and food processors that qualify for the state sales and use tax exemption on their purchases of diesel fuel are incurring severe cash flow difficulties. The law requires that these retailers pay the prepayment of the fuel when they purchase the fuel (currently at a rate of 8 cents per gallon) and claim a credit on their return for the period in which the fuel was sold. Because these retailers are only receiving partial reimbursement of the tax from the farmers and food processors (since the sale of the diesel fuel is exempt from the state tax portion), the retailers are ending up with a significant credit of overpaid prepayment on their tax returns. Because the credit can be sizable, and because the time lag between the time the payment of the prepayment to the supplier is made and the time the return is filed, and the associated refund is processed by the Board, many diesel fuel sellers are incurring a severe negative cash flow. Some retailers are even borrowing money simply to run their business because of this issue. In a recent letter from such a retailer, the excess credit amounted to over \$89,000 for one quarter alone.

In order to provide assistance to these retailers to the extent the Board can administratively, the Board staff has been expediting the refunds due the retailers. In addition, staff is offering these retailers with alternatives in filing their tax returns. For example, many of these retailers normally file a return quarterly. In order to identify the overpayment faster and issue a refund sooner, staff is providing an option to the

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retailers to, instead, file monthly returns. Also, the staff is suggesting to retailers to submit copies of their returns to a specific address in order to expedite the refund process.

## COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the California Independent Oil Marketers Association. Its purpose is to enable those retailers of diesel fuel with substantial exempt sales to farmers and food processors to acquire that portion of their fuel without payment of the prepaid sales tax to the supplier. This would eliminate the severe financial hardship the current prepayment requirements are placing on these smaller distributors of fuel.
2. **Enactment of this bill would resolve the problem.** While the Board has taken steps to administratively assist these distributors, these steps still do not solve the problem, since the distributors are still faced with the cash flow difficulties. The retailers are still incurring the cash flow difficulties, since, in spite of everything, they still have to file their tax return and wait for the Board to issue the refund. Enactment of this bill would provide the necessary mechanism to eliminate the refund process, and to enable the retailers to acquire the fuel without payment of the 8 cents per gallon prepayment. We estimate that approximately 150 fuel sellers may be impacted by the enactment of this measure.

## COST ESTIMATE

Some additional administrative workload would be incurred in notifying affected retailers, responding to inquiries, and approving claimed exemptions. A detailed cost estimate is pending.

## REVENUE ESTIMATE

Enactment of this bill would not materially affect the state's revenues.

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